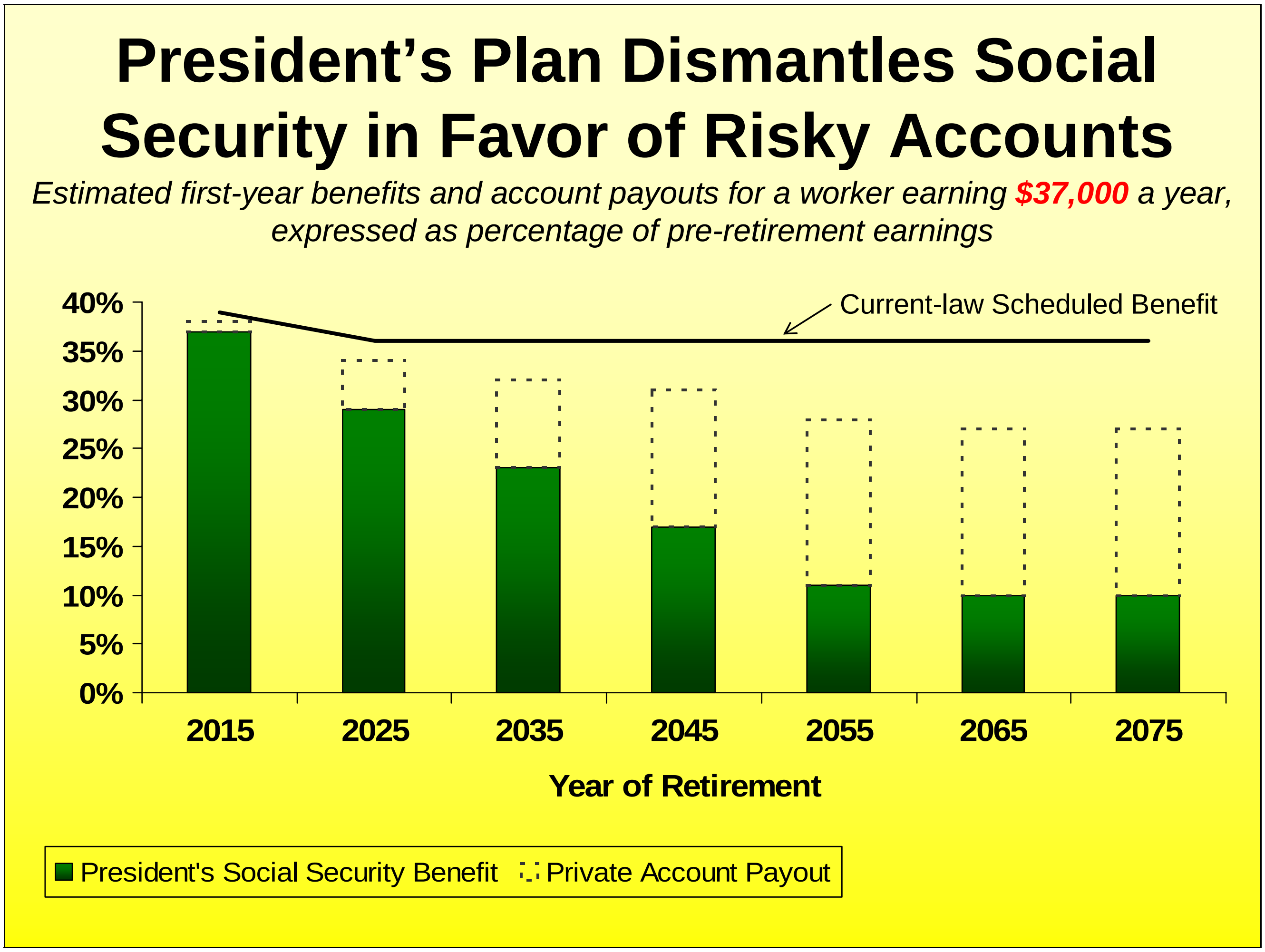
The President's Plan Dismantles Guaranteed Benefits In Favor of Risky Accounts



[chart also available showing results for $59,000-a-year worker – see Appendix]

The chart shows the combined Social Security benefits and private account payouts that workers earning $37,000 per year would receive under the President's plan, based on their year of retirement. The solid black line on the chart shows the level of benefits scheduled under current law. Benefits in the chart are expressed as a percentage of pre-retirement earnings, in order to illustrate Social Security's role in replacing wage income that is lost due to retirement or disability, as well as to provide a measure that is comparable over time.

The chart shows, for example, that under the President's plan, a person who is 15 years old today, earns $37,000 a year over her lifetime, and retires at age 65 in 2055 would receive a traditional Social Security benefit equivalent to only 11 percent of her pre-retirement earnings. Under current law, Social Security would replace 36 percent of her earnings. Her private account would replace around 17 percent of her pre-retirement earnings, depending on how her investments perform. The combined total from her traditional Social Security benefit and the private account would replace about 29 percent of her pre-retirement earnings.

What Rate of Return Can Private Accounts Be Expected to Earn?

The estimates for the private account payouts are based on a risk-adjusted rate of return, which equals the rate of return on government bonds. Under current assumptions, this is also the rate of return that an account would have to beat in order for the worker to come out ahead after paying the privatization tax. While private assets, on average, pay a higher rate of return than government bonds, the higher returns are accompanied by higher risks. Many financial economists recommend assuming a risk-adjusted rate of return when making projections, to account for the greater uncertainty associated with this risk. The Congressional Budget Office assumes a risk-adjusted rate of return when estimating how Social Security privatization plans will affect benefit levels for hypothetical individuals.